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SUBJECT: ITALY ON DEBT RELIEF FOR POOR COUNTRIES

REF: STATE 31823

1. (SBU) Summary. Italian Finance Ministry officials told Embassy Officers that Italy is carefully weighing the various proposals by G8 members and the International Monetary Fund (IMF)/World Bank for debt relief for the poorest countries. Finance Ministry officials hope that a consensus G8 proposal will emerge and asked about U.S. flexibility to achieve a common proposal. Italy favors the IFF vaccine pilot program. Finance Ministry officials chided the United States for not maintaining our previous percentage share in the recent IDA 14 replenishment. Finance Ministry reaction to the U.S. proposal included the concern that non-Highly Indebted Poor Countries (HIPC)- and International Development Association (IDA)-eligible countries would be excluded, and that the World Bank IDA fund would become undercapitalized without new donor inflows to compensate for payments eliminated on forgiven debt. Finance Ministry officials also believe that HIPC debt to the IMF must be addressed together with IDA and Africa Development Fund (AfDF) debt and, again in this case, new inflows would be needed. End Summary.

Introduction

2. (SBU) On March 9, and again on April 27, Economic Officer and Specialist met with Francesca Manno, Finance Ministry Director of International Financial Relations, and Maria Luisa Panzica, Manno's Economic Advisor, to discuss poor country debt relief. Both officials were well versed on the U.S. position from G8 and IFI-related meeting with their U.S. Treasury counterparts. Manno said that while Italy was not against the U.S. position, Italy did have some philosophical differences with the U.S. approach. Manno doubted that G8 members would endorse any single proposal, but thought that a hybrid approach would stand a better chance. She asked if the U.S. position was "take-it-or-leave-it," or if we were flexible.

Don't Forget Non-HIPC, IDA Countries.

3. (SBU) Manno emphasized that Italy backed, and had implemented, 100 percent bilateral debt relief for HIPC countries. However, she believed that the U.S. proposal is too narrow and noted the moral hazard in the U.S. approach of excluding non-HIPC, IDA countries. HIPCs are rewarded, while poor countries (non-HIPC, IDAs), which have better managed their debt, are ignored. Manno said that Italy preferred a country-by-country approach to allow G8 members to evaluate and act on debt relief for all poor countries, not just HIPCs.

Can't Bleed IDA; U.S. Plan Means Earlier IDA Replenishment.

4. (SBU) Manno chided the United States for not maintaining its IDA 13 percent share during the recently completed IDA 14 replenishment. She said even with its fiscal challenges, Italy maintained the same percent share between IDA 13 and IDA 14. She noted that under the U.S. approach to debt relief, IDA would lose too much capital, as its assets (the loans to HIPCs) were written off. Manno said either donor countries would need to provide new funds, or IDA would wither. Manno pointed out that this was an implicit cost in the U.S. proposal, even though our proposal claimed no net costs to donors.

Pay-As-You-Go for IDA Grants Increases Uncertainty.

5. (SBU) Panzica said there were problems associated with financing foregone principal on IDA 14 grants with additional donor contributions on a pay-as-you-go basis. She noted that the United States had been a strong proponent for increasing IDA grants to HIPCs. She said that pay-as-you-go requires

donor countries to make multiple requests to their

legislative appropriators, which actually increases funding uncertainty. Panzica explained that Italy's Parliament had only just approved in March 2005, euro 185 million for IDA 13, even though IDA 14 negotiations had already closed. Manno emphasized that funding for MDBs is a hot-button issue for some Italian lawmakers. She said Finance Ministry officials plan to meet more frequently with members of Parliament to keep them updated on MDB-related issues, and hopefully, limit excessive delays on future funding requests and keep discussions on a technical, not political, path.<sup>8</sup>

#### How to Fund Forgiveness of IMF HIPC Loans?

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16. (SBU) Manno noted that while the United States opposes IMF gold sales to pay for IMF debt relief to poor countries, the United States has not proposed an alternative mechanism to recapitalize IMF losses that would arise from writing off HIPC loans. In any event, Manno doubted that agreement could be reached to approve IMF gold sales to pay off IMF loans to HIPCs. Italy is interested in exploring alternative financing mechanisms, often referred to as variants on the Tobin tax<sup>8</sup> ) an infinitesimally small charge on financial transactions worldwide. Manno said that her office was not responsible for evaluating alternative financing mechanism proposed by a number of countries and institutions. She admitted some proposals could create market distortions or disadvantage select market segments, but mentioned an ongoing lottery, with tickets selling worldwide, as a possible funding approach with minimal market impacts.

#### Italy Supports IFF Immunization Pilot.

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17. (SBU) Manno said that Italy had not yet agreed to provide funds to the IFF Immunization Pilot, which Minister Siniscalco has publicly supported. She went on to say that the pilot program could easily expand or contract its geographical scope, if donor response was greater or lesser than expected. This meant Italy could decide at a later date whether or not to contribute funds, without adversely impacting the pilot program.

#### Comment

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18. (SBU) Italy clearly wants to be active in G8 debt relief initiatives. Manno and Panzica are well versed on the U.S. proposal, and Finance Minister Siniscalco has twice sought (unsuccessfully) to meet with Treasury Secretary Snow to discuss G8 development initiatives. End Comment.

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